CORPORATE TAXPAYER GROUP

C/- Deloitte Touche Tohmatsu
Attn: Mike Shaw
P O Box 1990
WELLINGTON
Telephone ++644 495-3932
Facsimile ++644 472-8023

30 October 2002

The International Taxation Project
Board of Taxation Secretariat
C / - The Treasury
Langton Crescent
Parkes ACT 2600
AUSTRALIA

Dear Sir/Madam

AUSTRALIAN TREASURY CONSULTATION PAPER
CORPORATE TAXPAYER GROUP SUBMISSION

We make the following comments by way of submission on behalf of the Corporate Taxpayer Group ("the Group") on the consultative paper published by the Australian Treasury entitled Review of International Tax Arrangements ("the consultative paper").

The Group comprises the tax managers from the major corporate organisations within New Zealand and includes tax managers from a number of trans-Tasman companies that have experience in the application of the Australian tax legislation.

We note that the opinions set out in the paper represent those of the Group and opinions of individual members may differ. We also note that the comments made in this submission are from the perspective of NZ based corporates which may have investments in Australia.

The Group believes that greater uniformity of tax regimes in different jurisdictions will lead to greater understanding by investors of investment implications, greater international investment, and reduced compliance costs imposed on multinational corporates.

EXECUTIVE SUMMARY

Our substantive comments can be summarised as follows:

- We support the Australian Treasury researching the effect on Australian companies of the dividend imputation bias and exploring solutions to this problem.

- We support expanding the number of broad list exemption listed countries.

- We submit that the Review of Business Taxation proposal to apply capital gains tax ("CGT") to the sale by non-residents of non-resident interposed entities with underlying Australian assets should not be proceeded with.

- We support providing conduit relief for Australian regional holding and joint venture companies.

- The Group supports expanding the foreign dividend account to provide a withholding tax exemption for all conduit income an Australian company distributes.

- The Group supports triangular tax and submits that this initiative is implemented notwithstanding the proposals in the consultative paper.

DETAILED ANALYSIS

The Group presents its detailed comments on its areas of interest below.

Chapter 2 Attracting equity capital for offshore expansion - Options for reducing a shareholder level tax bias against direct investment offshore

By way of introduction we note that the consultative paper (page 16) states that a possible bias occurs at the shareholder level against direct investment offshore. When calculating the returns to the ultimate resident shareholders, similar to the NZ tax regime, we believe that there is a tax bias against resident corporates investing outside their home jurisdiction under an imputation regime.

While we strongly support the retention of the imputation system (for the reasons set out on page 17 of the document), we believe that it can potentially be further improved by the proposals put forward in the consultative paper. As such, we look forward to seeing development of those proposals.

Our interest in seeing further changes to this area are that it will provide a platform for discussion on the NZ imputation regime. Further such changes should improve the tax efficiency of the investments made by NZ based corporates into Australian entities.

Chapter 3 Promoting Australia as a location for internationally focussed companies

Better targeting the controlled foreign company rules

By way of introduction, we make the following comments in relation to the CFC rules:

- We support the active income exemption to ensure the competitiveness of multinational companies (page 33), this is a position the Group has submitted on to NZ officials in relation to the regime that applies in NZ.

- We agree with the comments that CFC rules are complicated, give rise to significant compliance costs, and may impede the efficient restructuring of Australian multinational groups (page 34), this is also the experience of NZ based corporates effected by the NZ CFC regime. Proposals that recognise and address these issues are positive advancements.

- Given the complexity of the tax implications of cross border investments and the interaction of CFC rules, corporates will generally avoid investing in foreign companies which in turn have further foreign investments. For example, as a general statement, NZ investors will want to avoid direct (as compared with portfolio) investments into Australian corporates that invest outside Australia. This is due to:

  - The points noted above such as the added compliance costs.

- The existence of home jurisdiction CFC "look through" rules. For example where a NZ parent company has a direct investment into an Australian company, the NZ CFC rules will generally tax, on a current basis, any CFC income of the Australian company. Similar rules apply to the United States equivalent of the CFC rules.

- The inconsistency for Australia to tax non residents of Australia on income derived from sources outside Australia. This is potentially the situation where non residents invest through Australian multinationals.

Given the above, any proposals to reduce the impact of the Australian CFC rules where foreign investors have invested into an Australian conduit company will be a positive advancement. This will reduce the compliance costs and tax inefficiencies for NZ corporates that have CFC investments in Australia that may have subsequent investments outside Australia. Currently there is an incentive to restructure acquisitions of Australian corporates to streamline tax structures. Clearly any such proposals also have implications on the retention of Australian resident multinationals and attractiveness of using Australia as a regional headquarter.

3.3 Expanding the number of broad exemption listed countries to minimise compliance costs

Like Australia, the equivalent of broad exemption listed countries is a significant issue under the NZ CFC rules. In many situations, especially for distribution companies, there is no or minimal tax advantage obtained from investing into non broad exemption listed countries.

Where that foreign country does not provide for any significant tax preferences and it has a tax rate similar to that of Australia, applying the CFC rules only reduces the net economic benefits to Australia by adding compliance costs to Australian corporates. This does not maximise wealth creation.

We support expanding the number of broad exemption listed countries and believe that it is an important initiative. Providing a greater number of broad exemption listed countries will reduce the compliance costs and tax inefficiencies for NZ based companies that invest through Australia.

3.4 Australia's future tax treaty practice

We support the direction of the recently negotiated protocol to the Australia/United States tax treaty. We recommend that the Australia/NZ tax treaty be reconsidered in this light.

3.6 The application of CGT rules to the sale of non resident interposed entities with underlying Australian assets

The Group does not believe that the Review of Business Taxation proposal to apply Australian CGT to the sale by non resident of non resident interposed entities with underlying Australian assets should be proceeded with.

With transfer pricing rules, thin capitalisation rules and the introduction of the new tax consolidation regime, we believe that imposing such an additional tax would detract from Australia as a location for international investment.

We note that the imposition of this is contrary to recent changes to the Australia/United States tax treaty and other initiatives undertaken by various Governments (including Australia) to reduce taxes on foreign investment. It is generally accepted that reductions in taxes for foreign investors reduce the cost of capital to resident entities. This improves the economic welfare of the home jurisdiction. The proposed change is contrary to this and can only result in foreign investors increasing their expected returns to take into account this additional layer of tax.

Further we believe that any legislation that was introduced for such a purpose would be difficult to enforce (given that it potentially needs to be collected from taxpayers in foreign jurisdictions) and extremely complex.

Issues with such legislation include:

- Whether the rules will apply to non wholly owned groups. We note that whatever the threshold limit such a boundary would always provide a tax free exit strategy. Applying the rules to non wholly owned group raises significant practical problems such as determining when an Australian tax liability has crystallised and the cost base of the investment.

- Which taxpayer will be liable for the Australian tax, for example, the entity that is sold, the vendor of the entity that is sold, or the entity that actually holds the Australian investment. All these options raise practical issues such as determining when the tax liability arises and who must return the taxable income.

- The attribution of value to the Australian assets in groups or interposed entities that are sold. In the extreme, an interposed entity could be sold for nil consideration representing gains on Australian investments and losses on other non Australian investments.

- The treatment of foreign exchange ("FX") fluctuations on any gains. For example, non resident investors may make gains on Australian investments. However it must be noted that the non resident investor will also adjust such gains for FX movements. That is, it is not sound tax policy to tax gains that have never materialised due to offsetting FX losses or other losses.

- The treatment of other costs incurred by the non resident and the ability for the Australian authorities to review such expenditure.

- In some situations, even under NZ tax law that has no explicit CGT regime, the gain on the sale of Australian investments may be subject to tax. Implementing the proposed rule to a chain of group companies can result in double tax with **no** credit being allowed for any Australian tax that may be payable. This would result in Australia being viewed as a high tax jurisdiction with resulting implications for foreign investment.

- Other situations may arise where no credit is given for the proposed Australian tax, for example where gains are reduced by FX losses and other holding costs. In those situations the ultimate vendor may have no overall gain yet face an Australian tax liability for which no credit can be obtained in the foreign jurisdiction. Any potential imposition of double tax would seem undesirable.

- The requirement that rules be developed that encompass the costs to the acquirers of the interposed foreign holding vehicles. That is, if the sale of an interposed foreign holding vehicle is to trigger an Australian tax liability, the rules need to allow for the cost of that interposed foreign holding vehicle. If this is not addressed double Australian tax will arise as discussed above.

- Taxing gains made on interposed foreign holding vehicles is merely a timing difference as the original cost base of the underlying Australian tax asset remains. While in theory it may be possible to keep an interposed structure in place ad infinitum, this is not usually feasible in the commercial world. That is, the proposed rule may result in double Australian tax, first, from the sale of the interposed foreign holding vehicle and secondly if that holding vehicle directly disposes its Australian investment(s).

- We note that if the Australian investment's assets are predominately outside Australia, then taxing non resident shareholders on the sale of any interposed foreign holding vehicles is effectively taxing non resident investors on non Australian sourced income. This is being addressed in the consultative paper in terms of Option 3.10. If the above proposal (Option 3.6) is not implemented we believe that the relief being considered under "Option 3.10" needs to be expanded.

While we do not support the proposed legislation, should this proposal be taken further comprehensive consultation will need to occur so that thorough and considered submissions can be made.

3.10 Conduit relief for Australian regional holding and joint venture companies

We believe it is not correct to seek to tax non-residents on income that is not sourced in Australia.

From the perspective of encouraging investment through or in Australia, we support the proposals to either establish a conduit holding company regime or, as a lower compliance cost option, to exempt capital gains from the sale of a non-portfolio interest in a non-resident company with an underlying active business.

3.11 Foreign income accounts

The Group supports the Review of Business Taxation's recommendation to expand the foreign dividend account to provide a withholding tax exemption for all conduit income an Australian company distributes. As chains of companies are common, especially in large groups, we believe that this will encourage, retain and facilitate the use of Australia as a place for foreign investment.

Triangular Taxation

The Group notes that the consultative paper states that some options for reforming Australia's dividend imputation system could affect the triangular taxation initiative.

The Group supports triangular tax and strongly submits that this initiative is implemented notwithstanding any proposals contained in the consultative paper.

CONCLUSION

Thank you for the opportunity to comment on this consultative paper. We believe that many of the proposals are very positive initiatives by the Australian Treasury and look forward to the outcome of the consultation process.

Yours sincerely

Spyros Papageorgiou
for Corporate Taxpayer Group
K:\FILES\Clients\C\Corptax\Tax\2002\Australian Treasury Submission3.doc